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PREFERRED CREDITORS IN A DEED OF TRUST.

A question of practical importance in this State, and one which, so far as can be definitely ascertained, has never been directly decided by our Court of Appeals, is, whether a creditor, who has filed his bill and set aside as fraudulent a provision in a deed of trust securing various creditors and giving preferences to them in order, first, second, third, and so on, but has failed to overthrow the deed *in toto*, takes the place and rank of the creditor whose debt is overthrown, to the extent of that debt; or, do the preferred creditors, lower in the order of preference than the creditor whose debt is overthrown, get the benefit of his overthrow.

I. UNPREFERRED ATTACKING CREDITOR.

1. *Does he take the place and rank of the creditor whose debt is overthrown to the extent of that debt?*

(*a*) The maxim of "*vigilantibus, non dormientibus, jura subveniunt,*" is a favorite with courts of equity, and in no case can it be better applied than to the present one. Is a creditor, who by due diligence and at much expense has unearthed a fraud, to be deprived of the fruits of his labor, thereby benefiting those who were unwilling to take the risk? In *Rappleye v. Bank*, 93 Ill. 402, Mr. Justice Sheldon, in delivering the opinion of the court, said: "Although apellant might have proceeded and have avoided the trust deed, and have subjected the estate thereby conveyed to the satisfaction of his judgment, or have had the lots sold on execution, he did not choose to assume that burden and expense. Appellee then assumed the undertaking of avoiding the trust deed, and succeeded in effecting the removal of the encumbrance, encountering all the delay and expense thereof. It is through this proceeding of the appellee that this estate conveyed by the trust deed has been secured for application to the satisfaction of these judgments. Appellant now comes forward to

appropriate to himself all the benefit. It does not seem just, and we think, under the equitable doctrine which courts apply in analogous cases, and the decision in *Lyon v. Robbins*, 46 Ill. 279, appellee is fairly entitled to a preference as a reward of his diligence. Also see *McDermutt v. Strong*, 4 Johns. Ch. 687; *Smith v. Lind*, 29 Ill. 24."

In *Market Nat. Bank v. Hofheimer* (Va.), 23 Fed. Rep. 13, this position is further strengthened: "Creditors attacking a deed of assignment and unearthing a fraud intended to be consummated thereby, are entitled to the rewards of their diligence."

(*b*) Suppose the attacking creditor does not obtain the fruits of his labor, will not the deed be enlarged as to the later preferred creditors, a feature of the case for which the grantor did not provide? Shall the preferred creditors get more than that for which they contracted, and which the deed of assignment gave them?

Judge Hughes, in *Bank v. Hofheimer, supra*, is the only direct exponent in Virginia of the above view, so far as can be ascertained from an examination of the Virginia and Federal Reports, and his exposition is worthy of consideration. He comes to the conclusion that, as the deed did not provide for the contingency of some of the debts in a prior schedule being fictitious, which, in fact, was so, the amounts which were intended for them were not disposed of by the deed, but remained in the grantor as to attacking creditors, and were subject to their claims; that "*a successful attack by creditors upon a deed of assignment does not enlarge its operation as to those who claim under it;*" that "deeds of assignment giving preferences are to be construed strictly, and courts of equity will not interpolate phrases to carry out a possible intent to give preferences otherwise than as expressed;" that the deed being silent as to what should be done with the fund so set aside, it made no disposition of it whatever as against attacking creditors. *Prince v. Shepard*, 9 Pick. 184; *Tate v. Liggat*, 2 Leigh, 106. In the latter case a unanimous court decided that Liggat and Matthews (the attacking creditors) had preference over Morgan, a second lien creditor, on the ground that the latter contracted for, and the deed conveyed, only the excess after the satisfaction of the fair debt due the bank and the fraudulent debt due Tate; and, though the debt due Tate turned out to be simulated, that could not enlarge the operation of the deed.

The court, in *Bank v. Hofheimer*, then, being of the opinion that the fund, dedicated to the fictitious debts, was not assigned at all, but

remained in the Hofheimers, decided, according to the principle established in *Wallace v. Treakle*, 27 Gratt. 479, that the plaintiffs, by filing their bill and setting aside the fictitious debt, had established the first lien and were entitled to be satisfied to the extent of that fund.

(*c*) Another fact which has some bearing on this side of the question is, that courts of equity look with disfavor upon the principle of preference.

In *Boardman v. Halliday*, 10 Paige, 233, Chancellor Walworth characterizes this principle as "an erroneous principle, as injurious to the just rights of creditors as it is dangerous to the morals of the country."

"Assignments are often made the means of fraud and are not regarded in the courts with special favor." Bump on Fraud. Conv. (4th ed.), 375.

"Deeds of preference are to be construed strictly. They are in conflict with that prime and favorite maxim of the chancery courts that 'equality is equity.'" *Bank v. Hofheimer, supra.*

Mr. Burrill, in his treatment of this subject, says: "They [preferential clauses] have always been a subject of criticism, objection, or open condemnation, as founded on an unjust and erroneous principle. In the courts, where their principle, policy, and practical operation have been daily investigated and discussed, they have been viewed, especially of late, with a growing sentiment of jealousy and disfavor." Burrill on Assignments, 208. See, also, *Riggs v. Murray*, 2 Johns. Ch. 565; *Goodrich v. Downs*, 6 Hill, 438; *Barney v. Griffin*, 2 N. Y. 365; *Grover v. Wakeman*, 11 Wend. 187.

2. *Do the preferred creditors, lower in the order of preference than the creditor whose debt is overthrown, get the benefit of his overthrow?*

It is a well-settled principle of law that the creditor who first files his bill to set aside a conveyance as fraudulent, obtains thereby a priority, and is entitled to be first paid from the proceeds of the sale of land *if there are no prior valid liens.* Virginia Code, 1887, sec. 2460; *Wallace v. Treakle*, 27 Gratt. 487; 2 Min. Inst. 692; *Clark v. Figgins* (W. Va.), 5 S. E. 643; *Roanoke Nat. Bank v. Farmers Nat. Bank*, 84 Va. 603; *Brown v. Putney*, 90 Va. 453; *Noyes v. Carter*, (Va.), 23 S. E. 1.

A deed of assignment may be valid as to *bona fide* debts which it secures, and void as to fraudulent debts. *Billups v. Sears*, 5 Gratt.

31; *Paul v. Baugh*, 85 Va. 958; *Cohn v. Ward* (W. Va.), 15 S. E. 140.

Are there any prior valid liens? The answer must be in the affirmative. The attacking creditor, by only avoiding one of the provisions in the deed of assignment confirms the rest as to himself, and, accordingly, the position of the remaining *bona fide* creditors is determined. They are purchasers for value, and each has a lien from the date of the deed. The trustee in a deed of assignment for the benefit of creditors is a purchaser for value, and this benefit also inures to the *bona fide* creditors preferred in that deed of trust. If the trustee has a lien from the date of the deed, then the preferred creditors have a like lien, each according to the order of preference. This view is sustained by authority. Judge Daniel, in *Wickham v. Lewis, Martin & Co.*, 13 Gratt. 437, says: "And I think it has been the constant course of the courts in this State to regard the creditors in a deed of trust made by their debtor, *bona fide* for their indemnity, in the light of purchasers for value." In *Williams v. Lord & Robinson*, 75 Va. 404, part of the opinion is as follows: "These creditors, therefore, acquired a good title to the security of the deed of trust by accepting its provisions. They stood in the attitude of *bona fide* purchasers." *Exchange Bank v. Knox*, 19 Gratt. 739; *Gordon v. Rixey*, 76 Va. 698; *Lewis v. Glenn*, 84 Va. 965.

In *Cohn v. Ward* (W. Va.), 15 S. E. 140–1, Judge Brannon, after a criticism of Judge Hughes' opinion in *Bank v. Hofheimer*, says: "Diligence of the plaintiffs in overthrowing the debts is relied upon to give them the place of such debts. It is not a question of diligence, but of the imperious priority of *bona fide* debts under a valid deed of trust. Where a deed of trust is wholly set aside, and no debts secured by it have any standing or priority under it, they do not stand in the way, and the court gives a lien on the property to the creditors assailing it, from the date of the institution of their suit or filing their answer or petition seeking to set aside such deed, always, however, recognizing prior valid liens according to their date, as frequently held by this court. *Clark v. Figgins* (W. Va.), 5 S. E. 643; *Sweeney v. Sugar Refining Co.* (W. Va.), 4 S. E. 431. These cases do not antagonize our conclusion; on the contrary, they call for priority to the valid preferred debts in this case, for they are liens prior to the creditors attacking, by reason of a deed of trust held valid, and those liens are just as good against the attacking creditors as if they were judgments of date prior to this suit. It is hardly necessary to cite authorities to

show that, though a deed of trust may include fraudulent debts, yet *bona fide* debts thereby secured, their owners not participating in any fraud, have the benefit of the deed, and it is not void because of such fraudulent debts. *Cohn v. Ward* (W. Va.), 9 S. E. 41." All the later West Virginia cases hold the same. *Zell Guano Co. v. Heatherly*, 18 S. E. 611; *Hulings v. Hulings Lumber Co.*, Id. 621.

The syllabus in *Lewis v. Caperton*, 8 Gratt. 149, seems to conform to this view, though not directly in point: "There being several deeds, conveying in succession the same property, and not merely the equity of redemption therein, every successive incumbrance binds all the property not absorbed in satisfaction of the previous valid incumbrances. And if some of the incumbrances are declared void at the suit of a creditor of the grantor, such creditor is not entitled to have his debt substituted in the place of such void incumbrance to the extent thereof; but the subsequent valid incumbrancers have preference."

The liens of the other preferred creditors commence from the date of the deed, and they remain valid until they are overthrown. The lien of the attacking creditor only begins from the bringing of his suit, or, if he becomes a party to the suit by petition, from the time of the filing of the petition (Code, sec. 2460; Acts 1893–4, 614), and the former must therefore have priority.

II. Preferred Attacking Creditor.

A hypothetical case will serve to make the matter clearer. Suppose A makes a deed of assignment to B, as trustee, preferring as creditors in the order in which they come, C, D, E, and F. F, by filing a bill in equity, sets aside as fraudulent the provision in favor of D. Is he to be substituted for D to the extent of that debt?

"A person who is entitled to any benefit under a will or other instrument must, if he claims that benefit, abandon every right or interest, the assertion of which would defeat, even partially, any of the provisions of that instrument." *Rutherford v. Mayo*, 76 Va. 123.

In the terse language of Lord Rosslyn, in *Wilson v. Lord Townsend*, 2 Vesey Jr. 697: "You cannot act; you cannot come forth to a court of justice claiming in repugnant rights. When you claim under a deed, you must claim under the whole deed together; you cannot take one clause and advise the court to shut their eyes against the rest." *Penn v. Guggenheimer*, 76 Va. 846; Pomeroy's Eq. Jurisp., secs. 465–6; *Craig's Heirs v. Walthall*, 14 Gratt. 618; *Dixon v. McClure*, Id. 540.

"A creditor cannot hold an assignment good in part and bad in part;

if he ratifies it at all, he must stand by it." Burrill on Assign., sec. 476.

"In the case of a voluntary assignment, when the assignor creates his own trusts, a creditor who comes in to claim a share of the fund under it, must be contented to take such share of it as the assignor intended to give him, and cannot claim that which was intended to be given to the assignees in trust for others." *Pratt v. Adams*, 7 Paige, 615; *Chapin v. Thompson*, 89 N. Y. 278.

"By coming in under a voluntary assignment, the creditors express their election to accept of its provisions, and are considered as acquiescing in the disposition directed by the assignor to be made of the proceeds of the property." Burrill on Assign., sec. 479.

"He who accepts a benefit under a deed or will must adopt the whole contents of the instrument, conforming to all its provisions, and renouncing every right inconsistent with it." *Gregory v. Gates*, 30 Gratt. 89.

"A person cannot accept and reject the same instrument, or having availed himself of it as to part, defeat its provisions in any other part; and this applies to deeds, wills, and all other instruments whatsoever." 2 Herman on Estoppel, &c., p. 1156, sec. 1028.

Since the preferred attacking creditor cannot "claim under and against the deed at the same time," he must be considered as standing in the same position as the unpreferred creditor. He has taken his choice, and must give up the benefit which the deed provided for him, probably gaining nothing thereby, but even losing that which he already had.

Clark v. Ward, 12 Gratt. 440, seems to hold *contra*, but, from a close examination of the case, it will be seen that the preferred creditor sued out a foreign attachment against his debtor and sought to invalidate the transfer *on the ground that the deed was not duly recorded.* The recordation of a deed is essential to its validity as regards "creditors and subsequent purchasers for valuable consideration without notice" (Code 1887, sec. 2465), and the creditor only raised the point as to whether the taking possession of and the sale of the personal property by the trustees, was a valid transfer thereof as regards creditors and purchasers for value without notice. If not, he desired to protect himself by the attachment. The distinction between the two cases is narrow, though clear.

In the *former*, the preferred creditor attacks and sets aside as fraudulent one of the provisions of the deed, and wishes to be substituted for

the creditor whose debt is overthrown to the extent of that debt; and, if not, to hold his position as a preferred creditor. With the exception of that clause, the whole deed is valid as to him, and he can truly be considered as claiming "under and against the deed at the same time." In the *latter*, the creditor issued an attachment and sought to subject the property conveyed in the deed, on the ground that it was not duly recorded. The deed, of itself, if not recorded, was void *in toto* as to him, and he only raised the point as to whether the circumstances of the transfer and sale of the property by the trustees was equivalent to the recordation of the deed. In short, in the latter the main question was one of compliance with the statute, while in the former one of the provisions of the deed itself is questioned, attacked, and set aside as fraudulent.

But see, *contra*, *Peters v. Bain*, 133 U. S. 670, 696.

WM. W. OLD, JR.

Norfolk, Va..

RIGHT TO RECOVER PREMIUMS PAID ON A VOID POLICY.

A question of considerable interest and importance in litigation relative to contracts of insurance was decided by a Circuit Court in a recent case, in which the writer was of counsel for plaintiff.

The declaration alleged that the plaintiff had taken out a policy of insurance on the life of one in whom he had no insurable interest, and that he was entitled, the policy being void because of his lack of such interest, to a recovery against the defendant (the insurance company) of the premiums by him at divers times paid thereon. To this declaration the defendant demurred, and the demurrer was overruled by the court and judgment entered up for plaintiff.

It was vigorously contended by the defense that it ought to appear that the invalidity of the policy was known to the company in order to entitle the plaintiff to recover, if, indeed, even that were sufficient. The main ground relied upon by defendant was, that where the assured has no insurable interest in the life of the insured, the policy is invalid, because, in such a case the contract is purely wagering in its character, and, of course, for that reason, illegal, as well as for the additional reason, founded on sound public policy, that to uphold the